

The leasing of studio apartments and the operation of a dining hall by an exempt organization constitute unrelated trades or businesses where occupancy in the apartments is not primarily for the convenience of its members.

An organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 has asked whether under the circumstances described below the leasing of studio apartments and the operation of a dining hall constitute unrelated trades or businesses under section 513 of the Code.

The organization was created for the stimulation and fostering of public interest in the fine arts by promoting art exhibits, sponsoring cultural events, conducting educational programs, and disseminating information relative to the fine arts. Its activities are carried on in a building that contains offices, galleries, music rooms, a library, a dining hall, and studio apartments where artists may live and work. The studio apartments are leased only to artists, a few of whom are members of the organization. However, the apartments are not made available to the tenants on the basis of membership in the club or any criteria that would further the exempt purpose of the organization. The organization provides maid and switchboard services for the tenants similar to those provided to the occupants of rooms in hotels.

The organization operates the dining hall primarily to serve the tenants of the studio apartments and only incidentally to serve its employees.

Section 513 of the Code defines the term 'unrelated trade or business,' in the case of any organization subject to the tax imposed by section 511, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the purpose of function constituting the basis for its exemption under section 501 of the Code.

Section 513(a)(2) of the Code provides that the term 'unrelated trade or business' does not include any trade or business which is carried on in the case of an organization described in section 501(c)(3) primarily for the convenience of its members or employees.

Section 512(a) of the Code defines the term 'unrelated business taxable income' to mean, with certain exceptions, additions, and limitations, the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business. Section 512(b)(3) of the Code excludes from unrelated business taxable

income all rents from real property (including personal property leased with the real property).

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is 'substantially related' to exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes.

Section 1.512(b)-1(c)(2) of the regulations provides that payments for the use or occupancy of rooms or other space where services are also rendered to the occupant such as for the use or occupancy of rooms or other quarters in hotels, do not constitute rentals from real estate. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually rendered in connection with the rental of rooms for occupancy only. The regulations further provide that maid service constitutes such service.

Although the studio apartments are leased only to artists, they are not leased on the basis of any criteria that further the exempt purposes of the organization and occupancy in the apartments is not primarily for the convenience of the members within the meaning of section 513(a)(2) of the Code. The dining hall is operated primarily to serve the tenants of the studio apartments in their capacity as tenants. Thus, neither the leasing of the studio apartments nor the operation of the dining hall by the organization has a substantial causal relationship to the achievement of its exempt purposes. Because substantial services are rendered to the tenants, the payments by the tenants are not 'rents' within the meaning of section 1.512(b)-1(c)(2) of the regulations.

Accordingly, these two activities are unrelated trades or businesses under section 513 of the Code and the income therefrom is unrelated business taxable income under section 512 of the Code.